Presents

THE MECHANICS OF A BOND SALE

Session V

MARKETING AND PRICING AN ISSUE

Outline of Presentation

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Introduction

- What should your perspective be as an issuer?
- The underwriter is a means to an end
- The investor plays a long-term role
- You must be able to live with the issue on a long-term basis

Primary Role of the Underwriter

- Buy bonds from you at wholesale
- Sell bonds to investors at retail

Approaches to the Offering

- “Straight” retail offering:
  - retail often offers lower interest rates
- Institutional offerings
  - path of least resistance
  - used when “quick” is more important than “cheap”
- Combination:
  - the usual pattern, involving both retail and institutional accounts

Marketing the Issue

- In competitive sales:
  - occurs very late
  - is “open-ended”
  - requires certain features in the issue
  - rarely focuses intensely on single investor groups
- In negotiated sales:
  - starts earlier
  - usually oriented to specific investor(s)
  - allows customizing
  - must be managed to produce the “best” sale rather than the “only” sale

So Many Prices, So Few Bonds

- Bid price:
  - the price the underwriter pays you
- Offering price:
  - the price paid by the final investor
- Concession prices
  - to members of the syndicate ("takedown allowed")
  - to other dealers (including "selling group") (called the "concession" price)

How Do the Players Get Paid?

- Example: Issuer sells bonds to syndicate at 98.75% of par value (the “bid price”). Syndicate decides to offer bonds at par (100%) (the “offering price”).
  - The "spread" of 1.25% ($12.50/1,000 of par value) is apportioned as follows:

Bid Price =	*98.75%*
Syndicate expenses =	*0.10%*
Concessions to dealers =	*0.25%*
Additional “takedowns" to members =	*0.65%*
Syndicate "target" profit =	*0.25%*
Established offering price =	*100.00%*

How the Bonds Get There

Issuer sells bonds to syndicate

(Issuer's rates are now fixed)

Syndicate buys bonds from issuer

(Syndicate now "at risk")

Member takes down bonds from syndicate account

(Syndicate makes underwriting spread)

Member sells bonds to:

Investor (or to non-member dealer)

(Member makes additional takedown in case of sale to non-member; both concession and add'l takedown in case of sale to investor)

Non-member dealer sells bonds to investor

Investor

Factors Affecting Bond Prices

- Fundamental factors:
  - economic environment
  - inflation
  - general level of rates
  - other "numbers" the market is watching
- Technical factors:
  - security and rating
  - supply and demand
  - secondary liquidity
  - potential for price appreciation

Your Marketing Plan

- Planning:
  - do it early!
  - write it down!
  - identify the targeted audience!
  - make it consistent with method of sale you've selected!
- Executing:
  - communicate expectations
  - stay involved
  - know what's really "comparable"
  - start early and give it appropriate amount of time

Receiving the Bid

- Critical information:
  - strength of market
  - quality of orders as well as quantity
  - how many bonds on the “street” after the award?
- Do I care if the underwriter loses money?
- What happens after the award is important
  - MSRB trade activity reporting system as a resource
  - Reports from the underwriter at syndicate/account closing

The Offering

- You have been instructed to structure an offering of lease COPs or lease revenue bonds in an amount sufficient to raise $10.0 million for Sandpointe's new city hall project
- Your underwriter, Bonds, Bonds, and Stillmore Bonds, has offered to place the issue (as part of a syndicate) for a gross spread of 1.25% of the par amount of the offering
- The costs of issuance are expected to be about 2% of the amount borrowed
- You have determined that this will be a ten year loan, since the city hall project is intended to be a "temporary" rather than a permanent home for Sandpointe's offices
- You are NOT going to fund a reserve fund from the proceeds of the issue (this is not usual; used for purposes of this illustration only)

Overview of Pricing Process

- Developing a sense of the market:
  - rates, indices, etc.
  - supply and demand
- Preliminary pricing:
  - recent issues
  - secondary market as predictor
  - the competition
  - using benchmarks
- The order process:
  - who's playing; who's not
  - prices at which orders are entered
  - relationship of yield and spread
  - handling exceptional items
  - negotiating tips
  - the "bid" to purchase

Proposed Pricing & Comparables

	$10,000,000	$3,000,000	$100,000,000	$12,000,000
Issue:	"Newbonds"	"Otherbonds"	"Statebonds"	"Likebonds"
Maturity	City Hall COPs	Golf Course	Gen'l Obligation	Court House
2005	1.55%	2.00%	1.45%	
2006	1.90%	2.35%	1.80%	
2007	2.25%	2.75%	2.10%	
2008	2.55%	3.05%	2.45%	
2009	2.95%	3.35%	2.75%	2.90%
2010	3.20%	3.55%	2.95%	3.15%
2011	3.45%	3.80%	3.20%	3.40%
2012	3.65%	4.00%	3.35%	3.60%
2013	3.80%	4.15%	3.50%	3.75%
2014	3.90%	4.25%	3.65%	3.85%
Callable:	'13 @ 103	Non-callable	Non-callable	'09 @ 100
Rating:	A/A-/NR	NR/BBB+/BBB	Aa/AA/AA	A/NR/A+

Results After Order Period

Maturities	Amounts	Coupon Rates	Prices Yields	Concession and Takedown	Orders	Comments
2005	930,000	1.55%	100%	3/8 + 1/4	850	Retail, advisory, (500 stocked by senior manager)
2006	945,000	1.90%	100%	3/8 + 1/4	All	A.O.N. w/'07's
2007	960,000	2.25%	100%	3/8 + 1/4	All	(See '06)
2008	985,000	2.55%	100%	1/2 + 1/4	1,900	Stocked by members
2009	1,010,000	2.95%	100%	1/2 + 1/4	300	Stocked by members
2010	1,040,000	3.20%	100%	1/2 + 1/4	2,600	Insurance company (on a "swap")
2011	1,070,000	3.45%	100%	1/2 + 1/4	3,350	3,000 stocked; 350 away to retail
2012	1,110,000	3.65%	100%	1/2 + 1/4	1,200	1,000 to hedge fund; 200 stocked
2013	1,150,000	3.80%	100%	1/2 + 1/4	4,000	2,500 to hedge fund; 1,500 to senior manager
2014	1,190,000	3.90%	100%	1/2 + 1/4	3,650	3,000 stocked by managers; balance to hedge fund

Negotiating the Final Price

Maturity	Amounts	Coupon	Price/Yield	Concession/ Add'l Takedown
2005	930,000	1.50%	100%	None/None
2006	940,000	1.90%	100%	1/8 + None
2007	960,000	2.25%	100%	1/8 + 1/8
2008	980,000	2.55%	2.50%	1/4 + 1/8
2009	1,005,000	2.90%	100%	1/4 + 1/8
2010	1,035,000	3.15%	3.10%	1/2 + 1/4
2011	1,070,000	3.40%	100%	1/2 + 1/4
2012	1,105,000	3.60%	100%	5/8 + 1/4
2013	1,145,000	3.75%	100	5/8 + 1/4
2014	1,185,000	3.85%	3.80% *	5/8 + 1/4

*Priced to the 2013 call at 103%

How Did You Do?

- Preliminary pricing:
  - TIC = 3.590462%
  - Interest cost of $2,004,175
  - Annual debt service of $1,239,417
  - Par amount issued of $10,390,000
- Final pricing:
  - TIC = 3.480743%
  - Interest cost of $1,971,332
  - Annual debt service of $1,232,633
  - Par amount issued of $10,355,000

$35,000 less overall debt; 1/10% savings in interest rate; $32,843 less total interest; almost $7,000 lower annual debt service; and, a call option at par instead of at a 3% premium!

Questions?

A Sample Case: Negotiating a Sale

The following part will give seminar participants an opportunity to participate in a “mock” pricing exercise, using the case study for the financing of the new city hall building for the fictional City of Sandpointe.